

# **Report of the auditor-general to the Limpopo Provincial Legislature and the council on the Vhembe District Municipality**

## **Report on the financial statements**

### **Introduction**

1. I was engaged to audit the financial statements of the Vhembe District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, the cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Property, plant and equipment**

4. The municipality did not account for all items of property, plant and equipment in accordance with SA Standards of GRAP 17, *Property, plant and equipment*. A difference of R151 662 288 was noted between the underlying accounting records and the amount of property, plant and equipment disclosed in note 2 to the financial statements. Consequently

the property, plant and equipment is overstated by R151 662 289. In addition there was a resultant impact on the depreciation, accumulated depreciation and accumulated surplus accounts.

5. As disclosed in note 2 to the financial statements, the municipality did not prepare reconciliation for work in progress (included in infrastructure assets) as required by SA Standards of GRAP 17, *Property Plant Equipment* (showing opening balance, additions, transfers, other movements and closing balance). Furthermore, I identified differences between underlying accounting records and work in progress balance as per note 2 to the financial statements amounting R154 551 259 (2013:R177 971 130). As the municipality did not maintain adequate systems for recording of infrastructure asset, I was unable to determine the possible misstatement of the balance by alternative means. Consequently, I was unable to determine whether any adjustment to property, plant and equipment was necessary.
6. The municipality did not adequately account for depreciation on property, plant and equipment, as required by SA Standards of GRAP 17, *Property, plant and equipment*. The effect on the financial statements was that property, plant and equipment was understated by R8 015 691 and depreciation was overstated by the same amount.
7. I identified differences amounting to R40 682 053 between the comparative figures in note 35 and adjustments processed in note 2 to the financial statements. I was unable to confirm the restatement by alternative means. Consequently the opening balances of property, plant and equipment were misstated by the same amount.
8. During 2013 I was unable to obtain sufficient appropriate audit evidence on whether all assets belonging to the municipality were recorded in the accounting records. My opinion on property plant and equipment was modified accordingly. My opinion on the current period's financial statement is also modified because of the possible effect of this matter on the current and comparative figures.

## Consumer Debtors

9. I identified a difference of R72 367 504 between the consumer debtors as per the statement of financial position and the underlying accounting records. Further, my procedures identified a difference amounting to R17 629 125 between the consumer debtors account in note 20 to the financial statement and the debtors age analysis. As the municipality did not maintain adequate systems for recording consumer debtors, I was unable to determine the possible misstatement of the balance by alternative means. Consequently, I was unable to determine whether any adjustment to consumer debtors stated at R17 849 623 (2013: R15 248 108) was necessary.
10. The SA Standards of GRAP 9, *Revenue from exchange transactions*, require the municipality to disclose an age analysis of the financial assets per customer type. The disclosures in the financial statements of receivables from exchange and non-exchange transactions per note 9 and 20 were not made in accordance with the requirements of SA Standards of GRAP9.

## Provision for debt impairment

11. The municipality did not assess at the end of each reporting period, whether there is any objective evidence that a financial asset or group of financial asset is impaired. The standard requires the municipality to first assess whether objective evidence of impairment

exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant in accordance with SA Standards of GRAP 104, *Financial Instruments*. I was unable to confirm the correctness of the value of the provision for debt impairment by alternative means. Consequently, I was unable to determine whether any adjustments relating to provision for debt impairment amounting to R28 245 711 (2013: R60 494 724) in the financial statements and the consequential impact on accounts receivable, surplus for the period and accumulated surplus, was necessary.

Furthermore, I identified a difference amounting to R13 195 642 between the provision for debt impairment as per the statement of financial performance and the underlying accounting records. As the municipality did not maintain adequate systems for recording provision for debt impairment, I was unable to determine the possible misstatement of the account by alternative means. Consequently, I was unable to determine whether any adjustment to the provision for debt impairment was necessary.

### Cash and cash equivalents

12. I identified unreconciled items amounting to R5 104 251 which were included in the year-end bank reconciliation. The unreconciled items related to the 2012 financial period but are still shown as unreconciled at 30 June 2014. As the municipality did not maintain adequate systems for recording cash and cash equivalents, I was unable to confirm the unreconciled items by alternative means. Consequently, I was unable to determine whether any adjustment to the financial statements was necessary.

### Finance lease liabilities

13. I identified a difference amounting to R3 559 752 between the long term portion of the finance lease liabilities in note 6 to the financial statements and the underlying accounting records. I was unable to confirm the difference by alternative procedures. Consequently, finance lease liabilities are understated by the same amount.

### Revenue from exchange transactions

14. I was unable to obtain sufficient appropriate audit evidence that the municipality has correctly charged consumers for all water supplied and accounted for all revenue from water transactions for the current year, due to the status of the accounting records. Meter readings were not consistently done on a monthly basis which resulted in consumers not being billed. I was unable to confirm revenue from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to consumer debtors stated at R17 849 623 (2013: R15 248 108) and revenue from exchange transactions stated at R86 929 093 (2013: R80 234 481) in the financial statements was necessary. During 2013, my opinion on revenue from exchange was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period figures.

### Expenditure

15. Included in expenditure is an amount of R3 143 296 relating to the prior financial year which was recorded as expenditure for the current financial year. Consequently, current year

expenditure was overstated and prior year payables understated by this amount. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

## Commitments

16. I identified an unexplained difference amounting to R818 481 906 between the commitment register and the commitments disclosed in note 29 to the annual financial statements. I was unable to confirm the commitments balance by alternative means. Consequently, I am unable to determine whether any adjustment relating to commitments of R1 279 668 225 (2013: R698 014 629), as stated in note 29 to the financial statements was necessary.

## Cash flow statement

17. The municipality did not prepare the cash flow statement in terms of the requirements of the SA Standards of GRAP 2, *Cash flow statements*. A difference of R147 557 753 (R254 439 256) was noted between the bank balance and the cash flow statement balance. I was unable to obtain sufficient appropriate audit evidence to confirm the cash flow statement difference by alternative means. Consequently, I was unable to determine whether any adjustment to the cash flow statement was necessary.

## Statement of changes in net assets

18. I was unable to obtain sufficient appropriate audit evidence for an unexplained difference of R209 384 183 between the total of the accumulated surplus account as per the statement of changes in net assets and the recalculated amounts in the same account. Consequently, I was unable to determine whether any adjustments to the accumulated surplus account in the statement of changes in net assets was necessary.

## Prior period error

19. SA Standards of GRAP 3, *Accounting policies, change in accounting estimates and errors* requires material prior period errors to be corrected retrospectively by restating the comparative amounts for the periods in which the error occurred, disclosing the nature of prior period error, the amount, and financial line item affected. The municipality's disclosure in note 35 to the financial statement does not include all prior error misstatement disclosure in terms of SA Standards of GRAP 3. As a result, the municipality has not complied with SA Standards of GRAP 3.

## Opinion

20. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## **Emphasis of matter**

21. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Significant uncertainties**

22. With reference to note 29 to the financial statements, the district municipality is the defendant in various legal claims. The district municipality is opposing the claims amounting to R35 576 886 as it believes it has reasonable grounds to defend each claim. The ultimate outcome of the matters cannot presently be determined.

## **Restatement of corresponding figures**

23. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of district municipality at, and for the year ended, 30 June 2013.

## **Material impairments**

24. As disclosed in note 16 to the financial statements, material impairments to the amount of R28 245 711 were made for trade receivables due to the district municipality's inadequate collection practices.

## **Material losses**

25. As disclosed in note 19 to the financial statements, material water losses to the amount of R318 610 019 were incurred as a result of inadequate management of water distribution.  
26. As disclosed in note 42 to the financial statements, material losses to the amount of R3 423 420 were incurred as a result of vandalism of municipal property.

## **Material underspending of the conditional grants**

27. As disclosed in note 10, the district municipality has materially underspent on the conditional grants to the amount of R115 003 997.

## **Irregular expenditure**

28. As disclosed in note 33 to the financial statements, the Municipality incurred irregular expenditure amounting to R38 195 338 due to the contravention of the Municipality's procurement policy.

## **Fruitless expenditure**

29. As disclosed in note 32 to the financial statements, the Municipality incurred fruitless and wasteful expenditure amounting to R6 096 273 due to penalties and interest incurred and payment of machinery without usage.

### **Unauthorised expenditure**

30. As disclosed in note 31 to the financial statements, the municipality incurred unauthorised expenditure of R112 413 716 as a result of expenditure in excess of the limits of the amounts provided for in the votes of the approved budget.

### **Withdrawal from the audit engagement**

31. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the district municipality, I would have withdrawn from the engagement in terms of the ISAs.

### **Additional matter paragraph**

32. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited supplementary schedules**

33. The supplementary information set out on pages X to X does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

### **Unaudited disclosure notes**

34. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

### **Report on other legal and regulatory requirements**

35. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

36. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of municipality for the year ended 30 June 2014:
  - Objective 1: Technical Services Department: Basic Service delivery
  - Objective 2: Community Services Department : Health, Social and Community Development
  - Objective 3: Development and planning Department: Economic Growth and Development
37. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
38. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
39. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
40. The material findings in respect of the selected objectives are as follows:

### **Reliability of reported performance information**

#### **Technical and community services**

41. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
42. The reported performance information for technical services and community services departments was not valid, accurate and complete when compared to the source information or evidence provided.
43. This was due to the lack of standard operating procedures for the accurate recording of actual achievements, monitoring of the completeness of source documentation in support of actual achievements and frequent review of validity of reported achievements against source documentation.

#### **Economic Growth and Development**

44. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Overall, 25% of the targets were not reliable because I was unable to obtain sufficient appropriate audit evidence. This was due to incorrect recording of actual targets achieved.

## Compliance with laws and regulations

45. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

46. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46 (1) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **Budgets**

47. Expenditure was incurred in excess of the limits of the amounts provided for in the approved budget, in contravention of section 15 of the MFMA.

### **Financial statements, performance and annual reports**

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA

Material misstatements identified by the auditors in the submitted financial statements were not corrected and supporting evidence was not provided for audit inspection, which resulted in the financial statements receiving a disclaimer audit opinion.

### **Internal audit**

49. The internal audit unit did not achieve the planned targets as per the annual internal audit plan in contravention of section 165(2) of the MFMA.

50. The internal audit unit did not adequately advise the accounting officer on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

### **Audit committees**

51. The audit committee did not adequately review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the district municipality, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.

### **Procurement and contract management**

52. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
53. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

54. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
55. Awards were made to providers who are in the service of other state institutions in contravention of MFMA 112(j) and SCM regulations 44.

## **Human resource management and compensation**

56. An acting senior manager was appointed for a period of more than six months, in contravention of section 56(1)(c) of the MSA.
57. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of MSA.
58. The Chief Financial Officer was appointed without having met the prescribed minimum competency levels as required by section 56(1)(b) of the MSA.
59. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) MSA.

## **Expenditure management**

60. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.
61. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Conditional grants received**

62. Municipal Infrastructure Grant funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by sections 21(1) of the DoRA.
63. The Municipal System Improvement Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of DoRA.

## **Revenue management**

64. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
65. Accounts for water service charges were not prepared on monthly basis, as required by section 64(2)(c) of the MFMA.
66. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA

## **Asset and liability management**

67. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
68. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

## **Internal control**

69. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

## **Leadership**

70. The municipality's accounting officer is on precautionary suspension. The instability in the position of the accounting officer can result in a breakdown in internal controls. Significant matters identified during the audit require the accounting officer to intensify his oversight role and hold senior managers accountable.
71. Management did not always provide the required supervision and review over daily/monthly recording of transactions to strengthen the internal controls and ensure that the municipality complies with applicable financial reporting framework.
72. Action plans were developed, however, they were not fully implemented, reviewed and monitored, hence the recurrence of findings reported in the prior year.

## **Financial and performance management**

73. The municipality did not have a proper system of record management that provides for the maintenance of information that supports the reported performance contained in the annual performance report.
74. The municipality did not develop an effective system which verified the accuracy, completeness and reliability of the reported performance contained in the annual performance report.
75. The financial statements were not reconciled to the underlying records to ensure the accuracy, completeness and reliability of reported financial results.
76. Monthly reconciliations or checklists for financial reporting and compliance with laws and regulations were not subjected to proper review to ensure accuracy, completeness and reliability of reported financial results.

## Governance

77. Those charged with governance (council and audit committee) did not provide adequate oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

## Other reports

### Investigations in progress

78. On 1 August 2014 the President of the Republic of South Africa signed a proclamation authorising the Special Investigations Unit (SIU) to investigate maladministration, unlawful or improper conduct by officials, unlawful appropriation of public money, irregular expenditure and intentional or negligent loss of public money which took place between 1 May 2010 and the date of Publication of the Proclamation being, 1 August 2014. The investigation was still ongoing at the reporting date.
79. On 20 June 2014, Council placed the Municipal Manager on precautionary suspension while an investigation into the grading of the district municipality takes place. The investigation was still ongoing at the reporting date.

AUDITOR GENERAL

Polokwane

28 November 2014



*Auditing to build public confidence*